

Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 4902, *Relief from Liability*

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

Sales and Use Tax

The State Board of Equalization (Board) administers California's sales and use tax. The Board's Sales and Use Tax Department is responsible for administering the Board's sales and use tax programs.

Revenue and Taxation Code (RTC) section 6005 defines the term "person" for purposes of the Sales and Use Tax Law (RTC § 6001 et seq.). RTC section 6596 (section 6596), subdivision (a), provides for relief from sales and use tax, interest, and penalty charges due on a transaction or activity if the Board determines that a person failed to file a timely return or pay the tax because the person reasonably relied on written advice from the Board (hereafter referred to as section 6596 relief). For section 6596 relief to apply, section 6596, subdivision (b), provides that the Board must find that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

In addition, under section 6596, subdivision (c), a person requesting section 6596 relief is required to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires. And, section 6596, subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, implements, interprets, and makes specific the provisions of section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for section 6596 relief;
- Regulation 1705, subdivision (c), currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for section 6596 relief. The first sentence of Regulation 1705, subdivision (e), which was included in the 1999 amendments, currently provides that "[a] trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation."

Special Taxes and Fees

The Board also administers a number of special taxes and fees, in addition to the sales and use tax. As relevant here, those special taxes and fees are administered under the Motor Vehicle Fuel Tax Law (RTC § 7301 et seq.), the Use Fuel Tax Law (RTC § 8601 et seq.), the Cigarette and Tobacco Products Tax Law (RTC § 30001 et seq.), the Alcoholic Beverage Tax Law (RTC § 32001 et seq.), the Energy Resources Surcharge Law (RTC § 40001 et seq.), the Emergency Telephone Users Surcharge Act (RTC § 41001 et seq.), the Hazardous Substances Tax Law (RTC § 43001 et seq.), the Integrated Waste Management Fee Law (RTC § 45001 et seq.), the Oil Spill Response, Prevention, and Administration Fees Law (RTC § 46001 et seq.), the Underground Storage Tank Maintenance Fee Law (RTC § 50101 et seq.), the Fee Collection Procedures Law (RTC § 55001 et seq.), and the Diesel Fuel Tax Law (RTC § 60001 et seq.) (hereafter, collectively referred to as special tax and fee laws).

The Board's Property and Special Taxes Department's (PSTD's) special taxes and fees divisions are responsible for administering the Board's special tax and fee programs under the special tax and fee laws. Each of the special tax and fee laws have a corresponding statute to RTC section 6005, which defines "person" or incorporates a definition of "person."¹ Also, each of the special

¹ See RTC sections 7329, 8606, 30010, 32002 (incorporating the definition of person from Bus. & Prof. Code, § 23008), 40004, 41003, 43006, 45006, 46020, 50102 (incorporating the definition of person from Health & Saf.

tax and fee laws have a corresponding statute to section 6596, which authorizes the Board to grant a person relief from liability due to the person's reasonable reliance upon written advice from the Board.

Currently, under subdivision (a) of RTC sections 7657.1, 8879, 30284, 32257, 40104, 41098, 43159, 45157, 46158, 50112.5, 55045, and 60210 (hereafter referred to as the authorizing statutes), if the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of the special taxes and fees administered under the special tax and fee laws, and any penalties or interest added thereto. Currently, under subdivision (b) of the authorizing statutes, a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to a special tax or fee and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to the special tax or fee, or stated the conditions under which the activity or transaction is subject to the special tax or fee; and
- The special tax or fee liability due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

In addition, under subdivision (c) of the authorizing statutes, a person requesting relief is currently required to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires. And, currently, subdivision (d) of the authorizing statutes generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

Regulation 4902, *Relief from Liability*, implements, interprets, and makes specific the provisions of the authorizing statutes. As relevant here:

- Regulation 4902, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person;"
- Regulation 4902, subdivision (b), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for relief; and

Code, § 25299.25, which incorporates the definition of person from Health & Saf. Code, § 25281), 55002, and 60008.

- Regulation 4902, subdivision (c), currently applies to audits, states that the “[p]resentation of [a] person’s books and records for examination by an auditor shall be deemed to be a written request for the audit report,” and prescribes the circumstances under which an audit report may be relied upon for relief.

Also, as relevant here, subdivision (e) of Regulation 4902 explains the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for relief. And, Regulation 4902, subdivision (e), currently provides that “[a] trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation.”

As a result, a person cannot generally obtain relief from special taxes and fees by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 4902 does currently allow a person to obtain relief from special taxes and fees by relying on written advice the Board gave to the person’s representative or trade or industry association under specified circumstances.

Proposed Amendments

Need for Clarification

Prior to the Board’s adoption of Regulation 4902, the Board had adopted Regulations 1124, *Relief from Liability*, 1248, *Relief from Liability*, 1335, *Relief of Liability*, 1422, *Relief from Liability*, 2250, *Relief of Liability*, 2432, *Relief from Liability*, and 2570, *Relief from Liability*, which are applicable to section 6596 relief under the authorizing statutes in the Motor Vehicle Fuel Tax Law, the Underground Storage Tank Maintenance Fee Law, the Use Fuel Tax Law, the Diesel Fuel Tax Law, the Oil Spill Response, Prevention, and Administration Fees Law, the Emergency Telephone Users Surcharge Act, and Alcoholic Beverage Tax Law, respectively. On February 5, 2003, the Board adopted Regulation 4902 to provide a single, detailed regulation with section 6596 relief guidelines for all special tax and fee programs administered by the Board’s PSTD, under the special tax and fee laws. Regulation 4902 was specifically developed to mirror the section 6596 relief provisions in Regulation 1705 and incorporates all of Regulation 1705’s previous amendments made through February 5, 2003, including the 1999 amendments to Regulation 1705 extending section 6596 relief to trade or industry association members when an association requests written advice on their behalf.

On February 5, 2003, the Board also adopted amendments to Regulations 1124, 1248, 1335, 1422, 2250, 2432, and 2570, which refer to the guidelines for section 6596 relief described in Regulation 4902. And, the Board adopted Regulations 2303, 3021, 3302, 3502, and 4105, which are all called “Relief from Liability” or “Relief From Liability,” to provide specific section 6596 relief regulations under the authorizing statutes in the Energy Resources Surcharge Law, the Hazardous Substances Tax Law, the Integrated Waste Management Fee Law, the Fee Collection Procedures Law, and the Cigarette and Tobacco Products Tax Law, respectively, that also refer to the guidelines for section 6596 relief described in Regulation 4902.

During its October 23-25, 2012, Board meeting, the Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for section 6596 relief. In response to ABC's arguments, the Board referred the issue of whether section 6596 relief from sales and use tax liabilities should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal, to the Board's Business Tax Committee (BTC) for further development.

At its August 13, 2013, BTC meeting, the Board voted to propose amendments to Regulation 1705 to extend section 6596 relief to a person who relies on advice provided in a prior audit of a person with shared accounting and common ownership because the Board determined that the amendments are reasonably necessary for the specific purpose of addressing the issue presented by the facts of ABC's appeal. During the same meeting, the Board also recognized that there might be another issue (or problem within the meaning of Government Code section 11346.2, subdivision (b)(1)) if there are similar regulations to Regulation 1705 that apply to the special tax and fee programs and the other regulations are not amended to conform to the amendments to Regulation 1705. Therefore, the Board directed staff to recommend conforming amendments to any special tax and fee regulations that are similar to Regulation 1705. As a result, staff determined that Regulation 4902 was the only special tax and fee regulation that was similar to Regulation 1705 and staff drafted amendments to Regulation 4902 to incorporate the language contained in the proposed amendments to Regulation 1705, in order to ensure the Board's programs are administered in a uniform manner.

December 17, 2013, BTC Meeting

Board staff subsequently prepared Formal Issue Paper 13-011, which recommended that the Board propose to add language to the end of the first sentence in Regulation 4902, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add the following language to the end of Regulation 4902, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for relief:

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

- (1) Is engaged in the same line of business as the audited person,
- (2) Has common verifiable controlling ownership of 50% or greater ownership or a common majority shareholder with the audited person, and
- (3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintains books and records and prepares returns for tax and fee programs administered under the Revenue and Taxation Code sections referenced under this regulation.

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

The formal issue paper also recommended that the Board amend Regulation 4902, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited “or a person with shared accounting and common ownership with the audited person” or by a legal or statutory successor to *that person*. And, during the December 17, 2013, BTC meeting, staff also recommended changing “that person” to “those persons” to make the amendments to subdivision (a) grammatically correct and fully consistent with a minor change to the proposed amendments to Regulation 1705 that staff would subsequently request and the Board would subsequently authorize later that same day.

Therefore, at the conclusion of the Board’s discussion of Formal Issue Paper 13-011 during the December 17, 2013, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 4902 recommended in the formal issue paper with the minor change recommended by staff. The Board determined that the proposed conforming amendments to Regulation 4902 are reasonably necessary for the specific purpose of addressing the issue (or problem) presented by the amendments to Regulation 1705 (discussed above).²

² The Board subsequently adopted the amendments to Regulation 1705 on January 16, 2014, with the minor change authorized on December 17, 2013.

The Board anticipates that the proposed amendments to Regulation 4902 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The adoption of the proposed amendments to Regulation 4902 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 4902.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-011, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its December 17, 2013, BTC meeting in deciding to propose the amendments to Regulation 4902 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 4902 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 4902 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 4902 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, subdivision (c) of the authorizing statutes currently requires a person requesting section 6596 relief from a special tax or fee liability due to the person's reasonable reliance on written advice from the Board to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the

person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires.

As previously explained, the proposed amendments to Regulation 4902:

- Clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person";
- Clarify that written advice provided in an audit may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person" or by a legal or statutory successor to "those persons";
- Clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person; and
- Require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for relief.

As a result, the proposed amendments will permit some additional persons to qualify for relief, and choose to incur any costs associated with requesting relief under subdivision (c) of the authorizing statutes. However, the proposed amendments do not require any person to rely on another person's audit report or file a request for relief under the authorizing statutes. Therefore, the proposed amendments do not impose any costs on any persons, including businesses.

In addition, there is a limited class of persons that will actually have the shared accounting and common ownership with one or more other persons described in the proposed amendments to Regulation 4902. And, each person in the limited class will only be eligible for relief due to the person's reliance on another person's audit report during the periods that the person actually has the shared accounting and common ownership with the other person and actually relies on the other person's audit report. Therefore, the proposed amendments to Regulation 4902 will provide some relief to some of the persons in the limited class described above. However, the proposed amendments will not benefit every person in the limited class described above, they will not have any impact on persons that are not part of the limited class described above, and the Board does not anticipate receiving a significant number of new requests for relief due to the proposed amendments.

As a result, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business that is in addition to whatever economic impact the enactment of the authorizing statutes has and will have on individuals and businesses. And, the Board has determined that the proposed amendments to Regulation 4902 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period. Also, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 4902 will neither create nor

eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 4902 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 4902 will not affect the benefits of Regulation 4902 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 4902 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 4902 may affect small businesses.